

ANALYSIS OF AMENDED BILL

Author: Villines, et al Analyst: Rachel Coco Bill Number: AB 2341
 Related Bills: See Legislative History Telephone: 845-4328 Amended Date: June 21, 2006
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT:	Elimination of Tax Clearance Process/Minimum Franchise And Annual Tax Relief
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SUMMARY

This bill would eliminate the requirement to obtain a tax clearance and, if certain requirements are met, suspend further liability for the annual or minimum franchise tax.

SUMMARY OF AMENDMENTS

The June 21, 2006, amendments removed a provision that would have permitted certain suspended corporations to seek dissolution without payment of the accrued liability for the minimum franchise tax for years in which the corporation was inactive and not doing business. The amendments added provisions that would eliminate the tax clearance certificate requirement. As a result of the amendments, the "This Bill" and "Revenue Discussion" portions provided in the analysis of the bill as introduced February 23, 2006, have been revised. The Board position has also been changed to Support. The remainder of the analysis of the bill as introduced February 23, 2006, remains the same and has been included below for convenience.

PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to simplify the business entity dissolution and cancellation process and allow entities more time to complete the steps necessary to dissolve or cancel their registration.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective upon enactment and would be operative as of that date. Certain provisions are operative for taxable years beginning on or after January 1, 2006.

POSITION

Support.

On December 7, 2005, the Franchise Tax Board voted 2-0, with the representative from the Department of Finance abstaining, to sponsor the language included in this bill.

Board Position:

<u> X </u> S	<u> </u> NA	<u> </u> NP
<u> </u> SA	<u> </u> O	<u> </u> NAR
<u> </u> N	<u> </u> OUA	<u> </u> PENDING

Department Director

Date

Selvi Stanislaus

6/28/06

ANALYSIS

FEDERAL/STATE LAW

Federal law does not impose a minimum franchise tax.

Every corporation (including a limited liability company (LLC) classified as a corporation) incorporated or organized in, qualified to do business in, or doing business in California must annually pay to the state a minimum franchise tax of \$800. The minimum franchise tax applies from the earlier of the date of incorporation or organization, qualification, or commencing to do business within California until the date of dissolution, surrender, or if later, the date the corporation ceases to do business in California. This liability exists regardless of whether the corporation is earning income.

Every limited partnership, LLC not classified as a corporation, and limited liability partnership (LLP) registered, organized, or doing business in California must pay to the state an annual tax in an amount equal to the minimum franchise tax until a Certificate of Cancellation or a Notice of Change of Status, as applicable, is filed with the Office of the Secretary of State (SOS). In addition, an LLC not classified as a corporation must also annually pay a fee determined by the total income of the LLC.

Generally, a corporation, an LLC regardless of how classified, and an LLP organized within the state or registered with SOS must receive a tax clearance certificate from the Franchise Tax Board (FTB) before SOS will file the appropriate termination documents to extinguish the existence of the entity or its qualification to conduct business operations in California. During the period between the filing of a certificate of dissolution with SOS and the issuance of a tax clearance certificate by FTB, a domestic corporation (organized in California) is considered "conditionally dissolved." A conditionally dissolved domestic corporation does not accrue liability for the minimum franchise tax.

To obtain a tax clearance certificate, a Request for Tax Clearance Certificate Form is completed and sent to FTB for review and resolution of the entity's tax liability. FTB is required within 30 days either to issue the certificate or to notify the person requesting the certificate of the conditions that must be met before the certificate will be issued.

If the taxpayer files a tax return marked "final return" without having previously filed the tax clearance request described above, FTB will treat the return as a request for a tax clearance certificate. The taxpayer will be provided with the forms, instructions, and other documents that are required to be filed with SOS or FTB to complete the withdrawal or dissolution process.

Before a tax clearance certificate can be issued, the entity must have filed all required tax returns and paid all fees, taxes, penalties, and interest associated with those returns. The tax clearance certificate may be issued based on one of the following:

- Taxes paid and returns filed,
- An assumption of tax liability by an individual who can prove satisfactory financial responsibility,
- A surety bond generally in the amount equal to twice the estimated tax plus interest, or
- A non-interest bearing cash deposit that is held by FTB as security.

THIS BILL

This bill would provide that the minimum franchise tax or the annual tax would not be assessed for a taxable year if three conditions are met:

- 1) The entity files a final annual tax or minimum franchise tax return for the preceding taxable year,
- 2) The entity did not do business in California after that year, and
- 3) The entity files documents for dissolution, surrender, or cancellation within 12 months of the due date of that final return, without regard to extension.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require minor programming changes to the department's systems, which can be accomplished during normal annual updates.

TECHNICAL CONSIDERATIONS

The bill would require an entity to file a final annual tax return for the preceding taxable year as a condition of receiving relief from tax. The phrase "return for the preceding taxable year," limits tax relief to a single year. In order to allow tax relief for more than one year, the language should be amended to state "return for a taxable year." This would expand the relief to any year in which a final tax return was filed.

There is also a minor technical error. Amendment 1 has been provided to correct it.

LEGISLATIVE HISTORY

AB 547 (Maldonado, 2001/2002) contained language similar to this bill. AB 547 failed to pass out of the originating house by the constitutional deadline.

SB 947 (Committee on Judiciary, Stats. 1997, Ch. 17) allowed the cancellation of tax for certain suspended banks and corporations that met specific criteria. The statute was repealed by its own provisions on January 1, 1999.

OTHER STATES' INFORMATION

The states of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* were reviewed because the tax laws in those states are similar to California's tax laws.

Each of these states has a different process for allowing business entities to dissolve, cancel, or withdraw. Generally, each of these states requires that the business entity resolve any tax obligations prior to the state recognizing the business entity dissolution, cancellation, or withdrawal.

FISCAL IMPACT

This bill would eliminate the workload of issuing tax clearance certificates, which costs the department approximately \$1.2 million each fiscal year. Existing staff would be needed until June 30, 2007 to eliminate the remaining inventory workload. Once all inventories have been cleared, the department expects to show a budget reduction beginning with the 2007/2008 fiscal year.

ECONOMIC IMPACT

Revenue Impact

This proposal would result in the following revenue losses:

Estimated Impact of AB 2341 Assumed Effective On 1/1/2007 (\$ In Millions)			
Fiscal Year	2006/2007	2007/2008	2008/2009
Eliminate Tax Clearance Process	No impact	No impact	No impact
Prospective Relief of Annual/Minimum Tax	No impact	-\$1.5	-\$3

Revenue Impact

Eliminating the tax clearance process would not impact the collection of the annual/minimum tax for entities that dissolve, surrender, withdraw, or merge. Data indicate that roughly 27,000 tax clearance certificates are issued in any given year.

For entities that file a final return, this bill would relieve the annual/minimum tax prospectively, if taxpayers complete the dissolution process within 12 months. Data indicate that roughly 17% of tax clearance requests fall into this category, or 4,600 business entities, plus an additional 2,100 other entities that do not have to file a tax clearance certificate (limited partnerships and limited liability partnerships). Nearly all of these 6,700 entities incur an additional annual/minimum tax liability between the time they file a final return and the time the process to dissolve or surrender is completed. It is assumed the department collects about half of the additional annual/minimum tax liabilities incurred by this category of entity; therefore, the annual revenue loss is approximately \$3 million (6,700 x \$800 x 50%). Based on the timing of amounts otherwise collected under current law, the first full-year impact does not occur until 2008-09.

LEGISLATIVE STAFF CONTACT

Rachel Coco
Franchise Tax Board
(916) 845-4328
rachel.coco@ftb.ca.gov

Brian Putler
Franchise Tax Board
(916) 845-6333
brian.putler@ftb.ca.gov

Analyst	Rachel Coco
Telephone #	845-4328
Attorney	Patrick Kusiak

FRANCHISE TAX BOARD
AMENDMENTS TO AB 2341
As Amended June 21, 2006

Amendment 1

On page 20, line 36, strikeout "Franchise Tax Board and shall notify the"